

THE ECONOMIC SITUATION

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December 2003

- Can it get any better than this? Well, not GDP growth.
- Hard times generate a capitalist surge.
- But taxes blunt the work ethic.
- No. The jobs haven't gone to China. They are just gone.
- But there's a whole lot of hurtin' going on.
- And for South Carolina?
- Another heroine to consider.

That Incredible Bread Machine

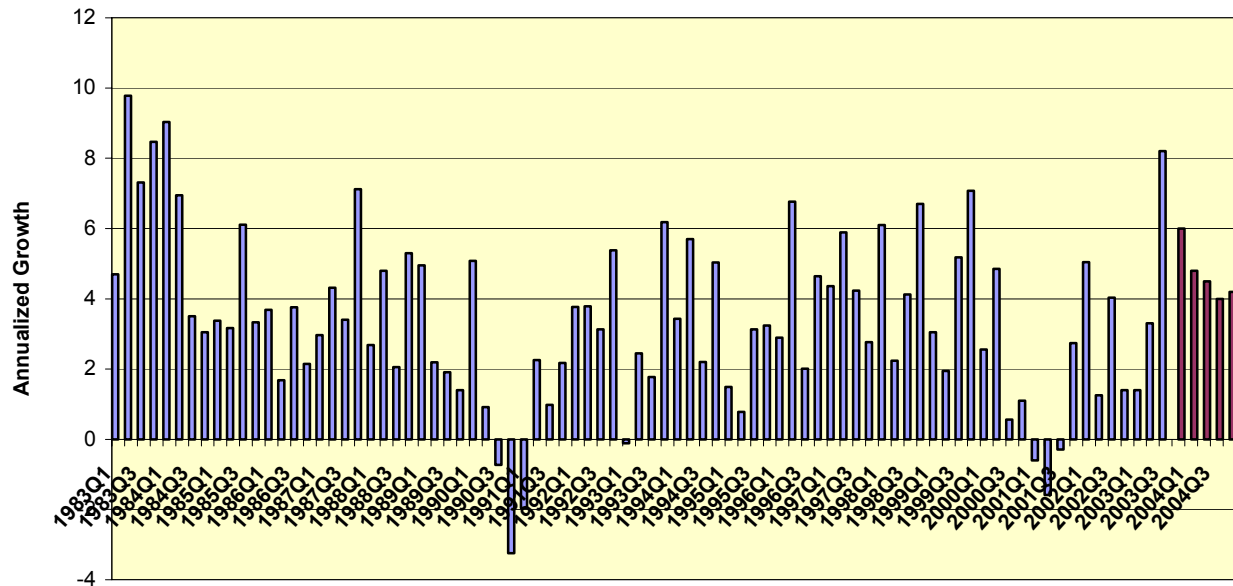
When the advance estimate of 3Q2003 real GDP growth was announced at 7.2% a few weeks ago, there were lots of nay-sayers who suggested the incredibly large number would be revised downward. They had history on their side. You would have to go back to 1Q1984 when GDP growth was 9.0% to find an equal or larger number.

Then, when the preliminary number was announced a few weeks later to be 8.2%, the nay-sayers were really shaken. It just isn't supposed to get that good!

Of course, the final number isn't out yet, but we should still celebrate. When GDP numbers are revised higher, it is an indication that smaller businesses are expanding. Their numbers tend to come in slowly. And after all, the Great American Bread Machine is driven by small businesses.

Just for the sake of celebration, I show below our trusty GDP chart with the tall 3Q2003 spike in place. I also show a summary forecast for some future quarters.

Real GDP Growth: 1Q1983-3Q2003 Estimates through 4Q2004



A quick glance at the forecast, which may be all it deserves, suggests we won't see tall timber GDP growth any time soon. But the forecast also indicates solid growth lies ahead. Corporate profits are an important element in this. With nonfinancial corporate earnings up 43% from a year ago—the largest jump in 20 years, the foundation has been laid for expanding operations and payrolls. The government's money valves are open. Interest rates are low, federal expenditures are soaring. Enjoy the ride!

The Capitalist Surge

The last Situation report described a labor market data problem that was yielding two entirely different pictures of the state of the economy. On the one hand, payroll data said lots of jobs were disappearing. Then, on that other hand, the household survey said lots of new jobs were being created. Efforts to explain how it can be that payroll data continue to show job losses while the Department of Labor's household survey shows surging employment received a bit of balm recently in the release of October's monthly income report.

The household labor survey shows an employment gain of 400,000 workers in the last 12 month. Now, the monthly income report shows a surge in proprietors' income of 8.6% in the last year. In the same 12 months, salaries and wages for individuals on corporate payrolls rose 2.3%.

It is interesting that politicians seeking office tend to focus on the bad news. No one seems interested in the capitalist surge taking place in the country. The fact that the individual business firms are small and not well identified may explain this.

There are no ribbon cutting opportunities for firms that have three people working for themselves.

Work and Taxes

Do you ever wonder why people choose to take on more hours work. Hardly. We all understand that additional hours worked leads to additional money in the old pay envelope. But what about taxes on those extra hours worked? If taxes are higher, do people still show the same interest in working longer?

This question motivated a study by economist Robert Prescott. He examined the marginal tax rate, what people pay on the next hour worked, across the seven largest industrial economies, the so-called G-7. He divided the total work-age population of each country into the total hours worked per week. Then, Prescott made a comparison across countries, taking into account the marginal tax rate in each place. His results are shown below.

Higher taxes mean less work.

G-7 Countries Labor Supply: 1993-96

| Country | Tax rate τ | Hours of Labor per Week per Adult |
|----------------|-----------------|-----------------------------------|
| Germany | 0.59 | 19.3 |
| France | 0.59 | 17.5 |
| Italy | 0.64 | 16.5 |
| Canada | 0.52 | 22.9 |
| United Kingdom | 0.44 | 22.8 |
| Japan | 0.37 | 27.0 |
| United States | 0.40 | 25.9 |

Just to check things out, Prescott looked at similar 1970s data. This was when U.S. taxes were among the highest in the G-7. Guess what? The French worked more hours per week than the U.S. adult population. The scheme worked again. Higher taxes mean less work.

G-7 Countries Labor Supply: 1970-74

| Country | Tax rate τ | Hours of Labor per Week per Adult |
|----------------|-----------------|-----------------------------------|
| Germany | 0.52 | 24.6 |
| France | 0.49 | 24.4 |
| Italy | 0.41 | 19.2 |
| Canada | 0.44 | 22.2 |
| United Kingdom | 0.45 | 25.9 |
| Japan | 0.25 | 29.8 |
| United States | 0.40 | 23.5 |

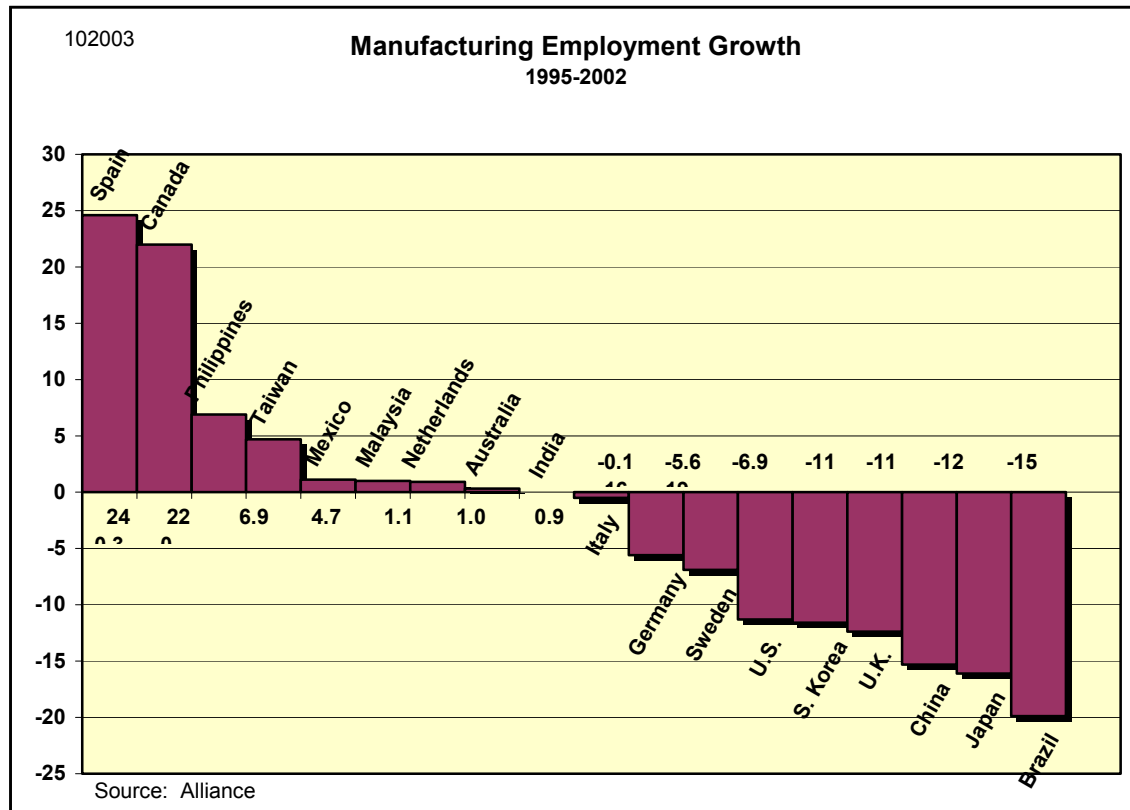
Where have the jobs gone?

More often than not, when plant closings and layoffs are announced there will be an indication that the jobs are going to China. When added together, job losses in the United States and Europe are sizable. The gains in China must be substantial.

Alliance Capital gathered data on the world's 20 largest manufacturing economies and asked what has been the percentage growth in manufacturing employment in recent years? When placed in a bar chart here's what the data say. Of the 20 countries, China shows

one of the largest losses in manufacturing employment. Well, did they go to India? India shows zero gain.

Where did the jobs go? They didn't go anywhere. Jobs in manufacturing are disappearing, worldwide. It just doesn't take as many people to produce the goods we all enjoy. Productivity gains and other efficiencies have changed the world.



China: The New World Trading Partner

From the viewpoint of the typical American producer or consumer, China is one vast exporter of goods to America. Indeed, China's exports have increased eight-fold since 1990, and the flow coming in this direction seems destined to increase. Our Chinese trading partners seem to be enjoying a one-way road to success. At least from America's perspective.

But there is more to the story. While China is a vast producer and exporter, the country is also a vast importer. Indeed, China runs an overall trade deficit with the rest of the world. To produce all those goods, China needs petroleum, steel, and many other inputs. They just happen to come from elsewhere.

It is China's demand for the world goods and for U.S. investments that makes the U.S. dollar attractive to Chinese traders. Were it not for the fact that greenbacks buy the world

goods and U.S. assets, there would be little reason for China to take pretty pieces of paper from the U.S. in exchange for a host of valuable consumer goods.

Even though the U.S. trade balance with China is in deficit, it is still the case that China is the fastest growing destination for American goods, this year worth \$20 billion and expanding at an annual rate of 20%. This and one more bit of information provided by Business Week's Laura Tyson give a rather happy face to China's soaring economy. The Chinese are the primary source for funding the U.S. fiscal deficit. They took some of the dollars we sent them and bought \$100 billion in federal debt in the last 18 months.

There's a Whole Lot of Hurtin' Going On

The Fed-induced recession, globalization of manufacturing, and the collapse of the dot.com bubble have combined to generate a lot of pain across the quilt of U.S. states. In an effort to broadcast these and related effects, the AFL-CIO developed an Economic Richter Scale that combines unemployment, lack of health-care insurance, and other measures of job-loss difficulties. The results, shown below, yield an interesting set of numbers.

| AFL-CIO Richter Scale | |
|-----------------------|--------------------------|
| North Carolina 9.3 | Delaware 4.3 |
| Mississippi 9.2 | California 4.2 |
| Michigan 8.2 | Rhode Island 4.0 |
| Colorado 7.7 | Minnesota 4.0 |
| Illinois 7.5 | Idaho 3.9 |
| Oregon 7.0 | Nebraska 3.9 |
| South Carolina 6.8 | New York 3.8 |
| Missouri 6.6 | Maryland 3.5 |
| Utah 6.4 | Virginia 3.4 |
| Texas 5.8 | Georgia 3.3 |
| Nevada 5.8 | W. Virginia 3.2 |
| Arizona 5.4 | Tennessee 3.2 |
| Indiana 5.1 | Wyoming 2.8 |
| Maine 5.1 | Alabama 2.8 |
| Ohio 5.1 | Kansas 2.7 |
| Pennsylvania 5.0 | N. Dakota 2.6 |
| Kentucky 5.0 | District of Columbia 2.0 |
| Wisconsin 4.9 | S. Dakota 2.0 |
| Hawaii 4.6 | New Jersey 1.9 |
| New Hampshire 4.6 | New Mexico 1.2 |
| Arkansas 4.6 | Alaska 1.0 |
| Iowa 4.5 | Vermont 0.9 |
| Connecticut 4.5 | Oklahoma 0.4 |
| Massachusetts 4.5 | Louisiana 0.2 |
| Washington 4.4 | Montana -0.7 |
| California 4.3 | |
| Rhode Island 4.2 | |

South Carolina's Outlook

A comparison of growth in employment by sector, for the U.S. and for South Carolina, provides a way to identify which sectors have borne the brunt of economic trouble and how the state compares to the country, sector-by-sector. The comparison is shown in the next table. A ratio of the S.C. percentage change to the U.S. change, where appropriate to calculate, is shown in the last column. Changes that are substantial different are shown in color.

| Sector | U.S. | S.C. | SC/US |
|-------------------|-------------|-------------|--------------|
| Total | -0.2% | -2.1% | 10.5 |
| Construct. | 1.9 | -1.2 | |
| Mfg. | -4.0 | -5.9 | 1.47 |
| Trade | -0.4 | -1.6 | 4.00 |
| Trans/Util. | -1.9 | 2.7 | |
| Information | 0.3 | -4.0 | |
| Finance | 1.4 | -2.4 | |
| Prof. & Bus. Svc. | 0.8 | -2.8 | |
| Ed. & Health Svc. | 1.9 | 0.5 | 0.26 |
| Leisure/Hospital. | 0.4 | -1.3 | |
| Other | -0.6 | -2.8 | 4.66 |
| Government | -0.3 | -1.6 | 5.33 |

Notice that the percentage change in total employment for South Carolina is 10 times larger than for the nation. The loss in trade jobs is four times larger. Even some of the state's services sector, professional and business services and leisure and hospitality services show losses.

With this analysis in mind, what are forecasters saying about the state's future economy.

Forecasting the Future S.C. Economy

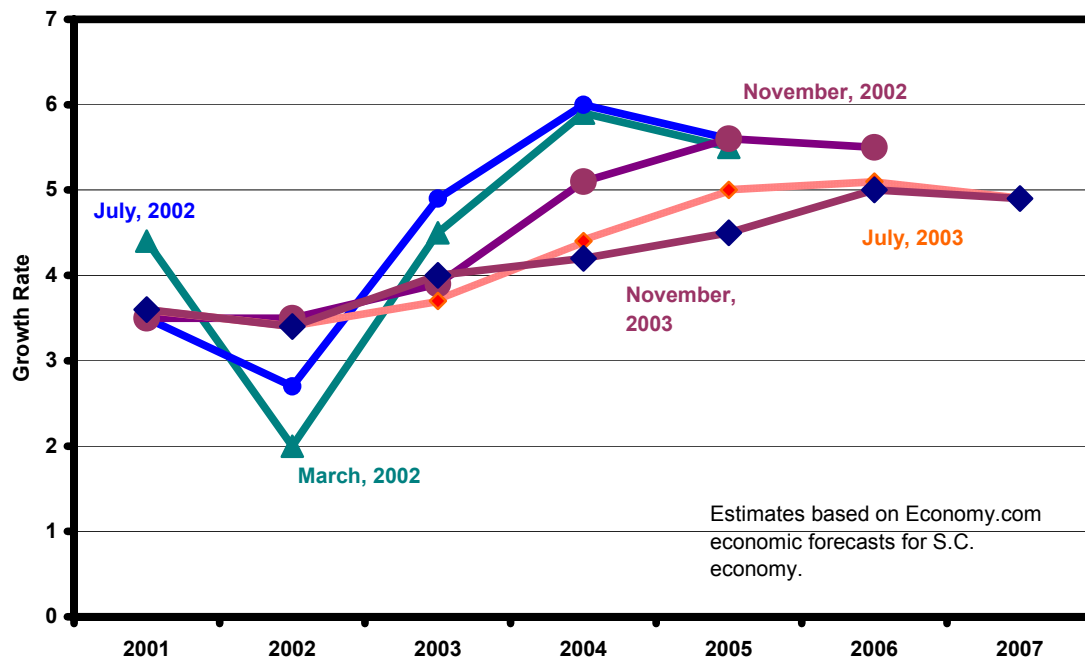
Economy.com provides a useful forecast for the S.C. economy. As indicated by the Richter rating, the state is one of the hardest hit by the combined manufacturing recession and globalization. Indeed, even now the outlook for employment growth is not very bright, although there are indications that the capitalist urge is generating some new enterprises. In fact, economy.com estimates 2004 employment growth will hit just 0.3%, after showing a

decline of 1.3% for 2003. By 2005, the economic engine should be running smoother, with employment growth rising to 1.9%.

The next chart plots patterns of state total personal income growth drawn from a series of forecasts. The various plots, which are labeled by forecast date, reflect the effects of changing economic conditions that enter the forecasters' brew. For example, the most recent November 2003 forecast is a bit weaker than the July 2003 array.

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S.C. INCOME GROWTH: COMPARING FORECASTS (Nominal Dollars)



Still Looking for Heroes

In my search for heroes, people who do well by doing good, I discovered a marvelous woman to add to the collection. Rosalie Edge (1877-1962) was a determined woman. She became incensed in 1929 when the Audubon Society promoted the destruction of falcons, hawks, and other so-called predator birds. At the time, the Society was promoting state payments of bounties to hunters who would help wipe out the varmints. Edge single-handedly brought Audubon to its knees, but it took court action for her to gain access to the organization's membership list. After that, it was easy. Rosalie Edge wrote every member and told them what their wonderful bird organization was doing to destroy bird life in America. Memberships dropped 30%; Audubon was reborn as a conservation organization.

But as impressive as this might be, it is just the beginning of a rich story. Later, Mrs. Edge heard about a special mountain in Pennsylvania prominently located along the flight path followed by hawks and similar birds. Every year when the flights were in full force, hunters gathered on Hawk Mountain to bring them down. The slaughter was so large that junk dealers struggled to get there first to gather the copper shell cases.

Rosalie decided to do something about Hawk Mountain. Did she go to the government and lobby? No. Did she try to get a statute passed to save the birds? No. She raised enough money to lease and then buy the mountain and manage it. With the deed on the shelf, she could call the sheriff if anyone trespassed on her mountain with a gun.

Today, the Hawk Mountain Sanctuary is still going full force.

Mrs. Edge did well by doing good.